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SUBJECT: ESTONIA'S STOCK MARKET CORRECTS; OUTLOOK STILL STRONG

Ref: (A) TALLINN 92 (B) RIGA 166

¶1. (U) During the month of February, the Tallinn Stock market hit an all time peak and then fell just over 20%. According to Embassy contacts and local analysts, the slide was driven by the profit-taking of local investors. It is not a harbinger of underlying weakness in the local or regional economy, or a reaction to broader global market trends. The economy is basically sound, (ref A) and the bulk of trading volume has been among individual investors rather than larger institutions, suggesting that this is not part of a larger flight of capital. With February's declines, the OMXT has given up nearly half of the gains it made since October 2006, when it began a rise of just over fifty percent in four months. Overall in 2006, the OMXT rose 48 percent, and it has averaged returns of 30 percent per year since it opened in 1996. Analysts expect that the Tallinn market may now fall all the way back to the October 2006 level, but nevertheless do not see this as a "crash" so much as "letting air out of the tires".

¶2. (U) Opened in 1996, the Tallinn stock exchange is a fully electronic exchange, and one of eight stock exchanges within the OMX Group comprising the Nordic Exchange. There are only fifteen (15) companies listed on the Tallinn exchange currently, and a relatively small percentage of the population is invested in the market. Thus, movements in the OMXT do not have the same impact on the Estonian economy that say, a 20 percent drop in the Dow Jones average would have on the U.S. economy. According to exchange officials, perhaps 100,000 Estonians (or less than 10% of the population) have securities accounts dating back to the GOE's privatization spree of the mid-1990s, however, there are only about 10,000-20,000 "active traders" today. The October 2006 start of the market's current gains coincided with the Initial Public Offering (IPO) of the exchange's most recently listed company, Olympic Casinos. This

heavily
promoted IPO coincided with a period of rising disposable income and
living
standards in Estonia. The combined effect was to push the whole
market up - a
relatively easy task given the OMXT's small size and low liquidity.

13. (U) The Tallinn Stock Exchange seems curiously insulated from
regional and
global market movements - such as the trends from China affecting
other markets
in Europe and the U.S. Exchange officials have pointed out that the
OMXT is not
particularly sensitive to interest rate changes by the European
Central Bank in
Frankfurt, because there are no banks or financial institutions
listed on it.
(Note: Tallinn Water, Olympic Casinos, retail & telecomm companies,
and the
Tallink ferry company are among the largest listed companies. End
Note.)
During recent speculation about whether the Latvian currency, the
Lat, would
have to be devalued, (ref B) both the Riga and Tallinn markets
registered
virtually no reaction to the news. This may be due in part to the
fact that all
trades are already cleared in Euros rather than local currency.

14. (U) The Tallinn exchange has plans for expansion later this
year.
Management Board Chairman Andrus Alber told us that by the end of
the year he
hopes to have an alternative market up and running, along the lines
of the
London-based Alternative Investments Market (AIM). This would
permit "more
entry points into the market" and greater access to capital for
small companies
by creating a market with lower capitalization requirements,
simplified rules
for company prospectuses, and fewer restrictions on the number of
issued shares.
(as well as fewer protections and greater risk for investors).
Alber expressed
confidence that regardless of what coalition comes out of Estonia's
recent
parliamentary elections, the new government will eventually pass the
legislation
needed to establish this new exchange.

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